

EXECUTIVE SUMMARY

During the past year, the global automotive industry entered a period of broad restructuring while Japan's recession continued unabated. While many automotive companies continued to struggle with the effects of the recession in Japan, others began to actively restructure their operations, including closing plants, cutting production, laying off employees, merging, forging cross border ties, and initiating other new business strategies. The impact of these changes on the Japanese automotive market undoubtedly will be significant. To facilitate this industrial restructuring and to ensure that it serves to enhance competition in the automotive market in Japan, the Administration believes that improving market access must be a priority for Japan. Indeed, President Clinton highlighted the importance of fully implementing our bilateral trade agreements, including the Automotive Agreement, during his May 3, 1999 meeting with Prime Minister Obuchi. Only by fully opening and deregulating its auto and auto parts sector will Japan foster the creation of a truly competitive automotive market, generating further progress under the Automotive Agreement and helping to spur Japanese economic growth.

In an effort to stabilize the economy and stimulate growth, the Japanese Government has enacted a variety of macroeconomic measures and financial sector reforms during this reporting period. If fully implemented, these steps will help to boost domestic demand, including in the automotive sector. At the same time, however, the Japanese Government has remained reluctant to take further steps to actively deregulate and fully open the economy and, specifically, the automotive sector. Rather than creating the pro-competitive regulatory environment that would help promote further automotive industry restructuring and increase this sector's efficiency and competitiveness, current Japanese Government policies serve to hold back needed changes and preserve the status quo.

These Japanese Government policies and the protracted recession have had a negative effect on auto parts companies, including foreign companies. Hard hit by the decline in Japanese auto production, which fell to a 20-year low in JFY 1998, U.S. auto parts exports to Japan fell 7.4 percent in 1998 compared with 1997, the first decline since the Agreement was signed in 1995. The decline bears out U.S. industry concerns about the growing difficulty of signing new contracts for sales of original equipment auto parts in Japan. Moreover, the continued fall off in new orders suggests that this decline is likely to continue.

The decrease in U.S. auto parts exports to Japan also reflects the slow pace of deregulation in the auto parts aftermarket, despite the continued deregulation that is called for in Automotive Agreement. Following the signing of the Automotive Agreement, the Japanese Government took a number of positive steps to deregulate its auto parts aftermarket. However, the Ministry of Transport (MOT) needs to take additional action to deregulate areas affecting aftermarket sales and operations in order to spur further actions by industry to restructure this sector, introduce more vigorous competition into the auto parts aftermarket, and achieve additional progress under the Agreement.

Japan's recession, limited market access, and the weak competitive environment also have hurt foreign vehicle manufacturers. Sales of DaimlerChrysler, Ford, and General Motors North American-produced motor vehicles in Japan fell 35 percent in 1998 over the previous year and declined 29 percent during the first quarter of 1999 over the same period in 1998.

In addition, the recession has inhibited business investment, compounding the difficulties foreign vehicle manufacturers face in adding new dealerships. In an effort to contend with these economic conditions and position themselves to better compete in the future, U.S. auto companies have consolidated or closed less-profitable dealerships over the past year. This restructuring may help companies weather the continued economic dislocations and position them for growth thereafter. However, the continued reluctance of some Japanese dealers to carry foreign vehicles for fear of damaging their long-term relationships with Japanese manufacturers will constrain the ability of U.S. companies to expand their dealership networks. While efforts by Japan's Ministry of International Trade and Industry over the past year to ensure that dealers understand that they are free to carry the products of competing manufacturers have helped improve the competitive environment somewhat, further proactive actions by the Japanese Government and Japanese automakers are needed to ensure that restrictive business practices in this sector are fully eliminated.

Senior-level Administration officials have raised their serious concerns over these trends in recent meetings with their Japanese counterparts. They also have strongly urged Japan to implement the 11 new concrete proposals that the U.S. Government presented to Japan, which include measures to increase competition in the auto parts market and strengthen dealerships. The U.S. Government has proposed that Japan deregulate and enhance the transparency of regulatory and administrative procedures involving vehicle inspection and repair, which would allow independent garages to compete for this high-profit business. Similarly, the MOT should remove additional items from the disassembly repair regulations (or so-called "critical parts list") in order to enhance competition in this sector and lower costs. (The disassembly repair regulations require that repair work on seven major component systems of an automobile -- *e.g.*, transmissions and brakes -- be performed at dealerships or other MOT-certified garages. These garages tend almost exclusively to use Japanese auto parts because they are owned or closely affiliated with Japanese automakers.) We urge Japan to implement these proposals expeditiously and will continue to consult closely with the Japanese Government on these issues in the weeks and months ahead.

Although we are disappointed with the overall Japanese Government actions to open and deregulate its automotive market, Japan has responded positively to some of the U.S. proposals. Last year, the U.S. Government requested that Japan help strengthen auto dealerships by streamlining new car registration procedures. Completing current registration requirements for new motor vehicles can consume almost one-quarter of the time of employees working in car dealerships, decreasing productivity and adding to the difficulties of running a profitable dealership. Japan has agreed to streamline this process, including through the creation of a "one-stop" shop for completing the required registration procedures. We welcome this step and urge

Japan to ensure that this “one-stop” shop is given the clear authority to handle all aspects of the multi-step registration process.

The Japanese Government also has agreed to create a new class of certified mechanics, as requested by the U.S. Government and industry. The United States sought this change to enhance the competitiveness and spur the development of the specialized certified garages -- a new category of garages established under the Agreement that has created opportunities for foreign auto parts suppliers by permitting smaller, independent garages to undertake repairs previously limited to dealerships and other fully designated or certified garages. The new class of mechanics will be trained, tested, and certified to work on all vehicle systems except engines. This will allow certified garages that do not perform repairs on engines to hire mechanics whose training corresponds to their needs and pay them accordingly. While we believe that this one new category is appropriate given the current state of development of this market, we urge the Ministry of Transport to continue to reassess the need for further sub-categories of mechanics as the market evolves.

Meanwhile, the Japanese automakers have continued to make major investments in new production facilities in the United States. This investment led to a 21-percent increase in purchases by Japanese transplants of U.S. auto parts during the first half of JFY 98 (the most recent available data), although auto parts imports from Japan also rose in 1998, the first increase since 1995. The major Japanese automakers recently provided reports on the status of their global business plans and reiterated their strong commitment to the U.S. market. The United States welcomes this continuing investment, which has created tens of thousands of new jobs for U.S. workers.

The United States is closely following developments regarding Japan’s new fuel economy regulations, which became effective on April 1, 1999. The U.S. Government fully recognizes the important environmental concerns that underlie these regulations. At the same time, we will continue to monitor this issue to ensure that the rulemaking process is fully transparent and that foreign vehicle manufacturers receive treatment no less favorable than that offered to domestic manufacturers.

The United States welcomes Japan’s intention to sign the Agreement on Global Technical Regulations. This agreement, which we expect both Japan and the EU to sign this year, will establish a process for developing truly global automotive safety and environment standards and regulations. We urge the Japanese Government to sign the Agreement as soon as possible so that the agreement may enter into force this September as scheduled.

The remainder of this report provides a detailed analysis of the 17 objective criteria included in the Agreement. These objective criteria were intended to allow the two governments to assess progress made in three areas -- motor vehicles, original equipment parts, and deregulation of the auto parts aftermarket -- which are the focus of the Agreement. The U.S. Government will continue to scrutinize Japanese Government implementation of this Agreement. We also will

continue to strongly urge Japan to take concrete measures to ensure that the Agreement's objectives to eliminate market access barriers and to expand sales opportunities in the automotive sector are fully achieved.